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C O N F I D E N T I A L SECTION 01 OF 02 SAN SALVADOR 000067

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E.O. 12958: DECL: 2020/02/08
TAGS: ECON EFIN SOCI PGOV ES
SUBJECT: El Salvador's Economy: A Glass Half-Empty

REF: 09 SAN SALVADOR 1238; 09 SAN SALVADOR 642

CLASSIFIED BY: Robert I. Blau, Charge d'Affaires; REASON: 1.4(D)

¶1. (C) SUMMARY: After seven months in office, the GOES has struggled to articulate either a clear economic policy or a clear security policy to address the two issues of greatest concern to the public. The GOES has few tools to use to prod the economy towards recovery, and the economy is heavily dependent on a US recovery. The private sector, inherently suspicious of a left-wing government, has lost much of its historic access to the highest levels of government and, in the absence of clear policy, now speculates the worst about the GOES's motives. While the Economic Cabinet has not made any major missteps or radical shifts from previous administration, its inaction is now hindering new investment and may, in fact, be prolonging the country's recession. End Summary.

¶2. (SBU) 2009 marked El Salvador's worst economic performance since at least the end of its civil war. After projecting no change in its GDP figures over the first six months of 2009, in December the GOES revised official projections downward to a 3.3% contraction of GDP for 2009. In 2009, exports fell 16.5% and imports fell 25.6%. Remittances, which make up about 18% of El Salvador's economy, fell 8.5%.

¶3. (SBU) Both the GOES and private sector concur that El Salvador will remain in recession through the first half of 2010. For the full year, however, the GOES revised its projection upwards to 1.0% GDP growth, while the World Bank projects 0.8% growth and Fitch Ratings projects 0.2% growth. On the other hand, Claudio DeRosa, an economist and former advisor to (center-right) ARENA Presidential Candidate Rodrigo Avila, told Econoff he agrees the economy will improve, but still projects a contraction of -2.5% to -0.5% for 2010. Given the first half of the year will be negative, he said, he cannot realistically see the economy growing fast enough in the last half to put the full year in positive territory.

¶4. (SBU) Leading economists disagree on whether there are any "green shoots" in the Salvadoran economy. In former Central Bank President Rafael Barraza's view, the maquila (textile and garment) sector will lead the recovery. He pointed to a smaller decline in maquila imports as an indicator that orders may be picking up, and that new exports will follow. DeRosa and economist Luis Membreno both dismissed this idea, however, arguing that the smaller decline was only due to comparisons with already weak 2008 numbers. Major US garment companies Fruit of the Loom and HanesBrand have started rehiring laid off workers, however, and HanesBrand representative Edwin Zamora projects that Hanes will be the largest employer in the country by the end of 2010.

¶5. (SBU) The Funes administration's most significant policy achievement was a tax reform passed in late December and implemented January 1 (reftel A). The GOES originally projected $250 million in new revenue, but the GOES is revising the figure downward to $190 million, asserting that changes made by the National Assembly on behalf of business were responsible for the lower tax receipts. Private sector representatives have complained about the complexity of the reform, and have noted that the GOES still has not explained how some of the taxes will be collected.

¶6. (SBU) The GOES's fiscal constraints have limited its ability to engage in counter-cyclical fiscal policy. Tax revenues fell 10.3% (preliminary) in 2009, driving up the budget deficit to 5.5%, with a 4.3% deficit projected for 2010. The only "stimulus" in the GOES "anti-crisis plan," announced soon after the Funes Administration took office, was the purchase of school uniforms (reftel B), a program since derided both in the press and by the private sector as mismanaged and ineffective. In a dollarized economy, the GOES is unable to use monetary policy to stimulate the economy. Minister of Economy Hector Dada has acknowledged to the press that a US economic recovery will be one of the main factors behind a Salvadoran recovery.

¶7. (C) The AmCham Executive Committee expressed concern to Charge and Emboffs that GOES Cabinet officials failed to coordinate with one another. They further asserted that the GOES is not articulating clear policies, especially on security and investment, causing uncertainty amongst investors. The AmCham also noted that the proliferation of new "secretaries" in the Presidency and the apparent power shift away from Ministers made it difficult to know who to approach on a particular issue. Separately, Luis Membreno, who served as a member of the Funes transition team, told Econoff that he and other informal advisors had lost their access and that the GOES Economic Cabinet had become increasingly isolated. He also described Alex Segovia, the President's Chief of Cabinet, as "missing in action" on shaping and articulating the administration's economic policy.

¶8. (C) COMMENT: 2009 was certainly an economic annus horribilis for El Salvador, but most economists think the worst is likely over. The trade benefits associated with CAFTA-DR will help to accelerate El Salvador's recovery as U.S. growth picks up in 2010. Growth in other Central American markets will also benefit El Salvador, but again, this growth will likely depend on the prospects for a robust U.S. recovery early in 2010. The domestic private sector has continued its "wait-and-see" approach to the Funes Administration, holding off on significant new investment until the economic picture becomes clearer. An additional negative factor is the rumbling from the hard-line FMLN that they will usher El Salvador into "21st Century Socialism." The GOES has both a five-year plan and an export promotion policy under development, though their success in reducing uncertainty will depend not only on the quality of the policies themselves, but also on a clear and consistent articulation of those policies by the GOES's senior economic officials.
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